SUPREME COURT OF THE UNITED STATES

OCTOBER TERM, 1940

No. 198

ROBERT R. COX,

Petitioner,

vs.

COMMISSIONER OF INTERNAL REVENUE,

Respondent.

No. 199

ETHEL K. CHILDERS,

Petitioner,

vs.

COMMISSIONER OF INTERNAL REVENUE,

Respondent.

BRIEF OF ROBERT R. COX AND ETHEL K. CHILDERS IN SUPPORT OF PETITION FOR WRITS OF CERTIORARI.

Argument.

We wish to emphasize that the trusts in the instant cases are not term trusts or any other form of temporary reallo-

cation of income within close family groups, but represent permanent dispositions of both income and corpus to the beneficiaries of the trusts, which in the *Childers* case includes two adopted children, a sister-in-law and two sisters. In the *Cox* case the beneficiaries include a brother, cousin, three children and the grantor's wife. In neither of the trusts is the relationship of the beneficiaries and the grantor such that they could be considered a close family group. The trusts contain usual and customary provisions and show on their faces that they were created to make permanent provision for the beneficiaries but to guard against dissipation by the beneficiaries of the assets forming the corpus.

A.

Where the grantor of a trust is one of the trustees and also one of the beneficiaries, a provision in the trust instrument permitting the trustees, in case the net income allotted for the benefit of any beneficiary is insufficient in the opinion of the trustees for his comfort, maintenance and/or education, to pay to such beneficiary such sums from the principal of the trust as may be necessary for such purposes, does not constitute a power to revest in the grantor title to the corpus of the trust, within the meaning of Section 166 of the Revenue Act of 1934.

The court below held in the instant cases that the power granted to the trustees, one of whom was the donor, under paragraph Second (d) of the Childers trust instrument and paragraph Second (c) of the Cox trust instrument (R. 39 and R. 16), to pay to any beneficiary such sums from the principal as might be necessary for the comfort, maintenance or education of any beneficiary, constituted a power to revest in the grantor title to the whole of the corpus, since by virtue of other provisions of the trust instrument

and the relation of the parties, the court considered it improbable that any beneficiary or the co-trustee would act to prevent the abuse of authority by the trustees under this section.

The trustees in the instant cases could make such payments to any beneficiary from the corpus of the trust, only on the contingency that the net income allotted for the benefit of such beneficiary is insufficient, in the opinion of the trustees, for the comfort, maintenance or education of such beneficiary (R. 16 and R. 39).

In the case of *Higgins* v. *White*, 93 F. (2d) 357, the Circuit Court of Appeals for the First Circuit held that a similar provision in the trust instruments involved in that case was not a "power to revest" in the grantor title to the corpus of the trust and that the income was not taxable to the grantor under section 219 (g) of the Revenue Act of 1926 (44 Stat. 32, 34), which corresponds to section 166 of the Revenue Act of 1934 (48 Stat. 680, 729). In that case, under one of the trusts, Clara C. Higgins, the grantor, was also one of the trustees and her husband and children were the beneficiaries. By the terms of the trust agreement the trustees might pay to grantor or to her children such sums out of the principal as the trustees might deem necessary or advisable for the "comfort, maintenance, support, advancement, education or welfare" of grantor or her children. The court decided the question on the broad ground that such a fiduciary discretion was not a "power to revest" in the grantor title to the whole corpus but that such a provision in the trust instrument was a fiduciary power which could be exercised only by the trustees as such after they had made a determination as trustees that it was necessary or advisable to use principal of the trust for the comfort, maintenance or support of Clara C. Higgins or the education of her children. The court held that the trustees

had a fiduciary duty to protect the interests of the beneficiaries against invasion of the corpus unless the contingency stated in the trust instrument were shown to exist. The same conditions are imposed on the trustees in the instant cases (R. 16 and R. 39).

In the instant cases the court below disregarded the rule of *Higgins* v. *White*, 93 F. (2d) 357, and extended the rule of *Rollins* v. *Helvering*, 92 F. (2d) 390, decided by the Circuit Court of Appeals for the Eighth Circuit. In the latter case a trust instrument gave the trustee power to pay to the grantor so much of the principal of the trust "as in its discretion it may deem advisable for our proper education, care, comfort and support." The case involved the taxability to the grantor of certain capital gains derived from a sale in August, 1929, which under the terms of the trust were to be considered as corpus. The trust instrument gave the grantor power to revoke any or all beneficial interests after January 1, 1930, without the consent of anyone, merely by giving notice prior to the end of 1929, which was only a few months after the trust was created. The court held that the grantor was taxable on the income from the capital gains under Section 167 of the Revenue Act of 1928, since the grantor could have distributed to himself these capital gains in 1929, and there was really no adverse interest whatever to object to such a distribution. In the *Rollins* case, neither one beneficiary nor all beneficiaries together could have successfully objected in court to a distribution to the grantor on December 30, 1929, of such capital gains, for the grantor could have given notice of revocation on December 31, 1929, and revoked the trust on January 2, 1930. The facts of the instant cases are quite different, for in these cases there is a real, continuing adverse interest in each beneficiary, which can prevent any direct revocation, or could prevent any concealed revocation by any attempted abuse of trustee powers by the grantor.

B.

Where property is transferred by an individual to himself and another as trustees, the powers granted to trustees to withhold and accumulate the income for future distribution to the beneficiaries; to determine the mode in which expenses are to be borne as between capital and income and to determine the proper division of receipts between capital and income; to freely invest the corpus and accumulated income; to pay to the beneficiaries such sums from the principal of the trust as may be necessary for the comfort, maintenance and education of any beneficiary in the event the net income allotted for the benefit of such beneficiary is insufficient therefor in the opinion of the trustees, do not constitute a power to revest in the grantor title to the entire corpus under Section 166 of the Revenue Act of 1934, when the only power reserved in the trust instrument to alter, amend or revoke the trust must be exercised with the consent of a beneficiary then sui juris and having a substantial adverse interest to the grantor.

The court below has assumed that, because of the relationship of the grantor and beneficiaries, no beneficiary would object to an abuse by the trustees of the powers granted to them under the trust instruments and that the grantor could, therefore, revoke the trust by abusing the powers as trustee. There are no facts in the record to justify such an assumption and the failure of a beneficiary to protect his interests against abuse of the powers granted to the trustees, would not lessen his rights, nor give the grantor any power under the trust instrument.

The Congress has specifically provided in section 166 of the Revenue Act of 1934, that the power to revest in the grantor title to the corpus of the trust, with the consent of a beneficiary having a substantial adverse interest to the grantor, shall not bring the trust within section 166.

Neither the Board of Tax Appeals nor the court below has suggested that any beneficiary in the instant cases did not have a "substantial adverse interest" in the disposition of the entire corpus or the income therefrom.

It cannot be disputed that the Kansas courts would, at the request of any beneficiary or of the co-trustees, prevent any abuse of powers granted to the trustees. *Keeler* v. *Lauer,* 73 Kan. 388, 85 Pac. 541 and *Niblack* v. *Knox,* 101 Kan. 440, 167 Pac. 741. The only way the grantor could use any part of the corpus for her own individual benefit and have such action sustained under local law would be to secure the consent to a revocation or alteration under paragraph Sixth of the instrument (R. 46) which would not bring the trusts within the provisions of section 166 of the Revenue Act of 1934.

C.

The power granted to E. K. Childers as one of the trustees, together with her relationship to the beneficiaries, do not make the trust a mere "sham" so that it should be disregarded for income tax purposes as lacking substance and the income taxed to the grantor under the provisions of Section 22 (a) of the Revenue Act of 1934.

The court below held that "* * * the trust amounted to no more than an arrangement for distribution of income to the family group in accordance with the will of the donor * * *", and consequently the income was taxable to the grantor under section 22 (a) of the Revenue Act of 1934.

The record herein clearly shows that title to the corpus was transferred to the trustees, that there has been a complete accounting to each beneficiary for his share of the trust income, and that no portion of the corpus of either trust has been withdrawn or distributed for any purpose whatsoever (R. 12 and R. 35).

Control over the corpus was in the trustees as such. No such control was retained by either of the donors as individuals. In *Helvering* v. *Clifford*, 60 S. Ct. 554, 308 U. S. —, relied upon so strongly by the court below, the donor, as such, retained much broader control than was given to the trustees in the instant cases. Clifford had absolute discretion to pay the whole or any part of the net income to the beneficiary, his wife. He retained full power as donor to vote the stock, to hold any of the trust property in his individual name or in the names of other persons. The title to the trust corpus was not transferred to the trustee but the donor merely declared himself trustee of certain securities which he owned.

All this is not true in the instant cases. Here, no control whatever was retained by the donors as such; all powers granted were trust powers to be exercised by the trustees acting in their fiduciary capacity; the trustees might accumulate the income but must set it aside in separate income funds "for future distribution to such beneficiaries;" only the trustees as such could vote the stock or sell or invest any of the trust property; and in each case the title to the trust corpus was actually transferred to the trustees. Clearly there was no such retention of control by the donors in the instant cases as the *Clifford* case.

The *Clifford* decision was predicted on three points taken together: The fact that it was a term trust; the retention of control by the donor as such; and the fact that donor's wife was the beneficiary. These are not the circumstances in the instant case.

The relationship of the parties in the instant cases is not such as can be considered a close family group. In the Childers trust the relationship of the beneficiaries to the grantor and their ages when the trust was created, follows: son, age 10; daughter, age 8; sister-in-law, age 48; sister, age 47; and a sister, age 40 (R. 35). In the Cox trust the

relationship of the beneficiaries to the grantor and their ages when the trust was created, follows: wife, age 36; daughter, age 8; daughter, age 6; son, age 5; brother and cousin (R. 11).

It is unusual for an individual to make a gift of property to a stranger. If the relationship of the beneficiaries to the donor in the instant case constitutes such a close family group within the intendment of the rule laid down in *Helvering* v. *Clifford*, 60 S. Ct. 554, 308 U. S. —, that a consent by the beneficiaries to a revocation of the trust or an abuse of trustee powers will be presumed, then very few trusts created by way of gift have any validity for income tax purposes. We do not so interpret this Court's decision in the *Clifford* case.

D.

The court below did not properly consider Section 22 (a) when that section was not raised in the argument before the court.

The Board of Tax Appeals held that the instant trusts were taxable to the grantors under section 167. In the Circuit Court of Appeals the respondent did not urge section 167 but contended that the trusts came under section 166. In its opinion the court below held that the income is taxable to the grantors under section 166 and also under section 22 (a). The latter section was not raised as an issue before the court below and should not have been considered. *Helvering* v. *Wood*, 60 S. Ct. 551, 308 U. S. —.

If the court's decision below should be upheld solely on the basis of section 22 (a), the cases should be remanded to the Board of Tax Appeals to give petitioners an opportunity to present evidence with respect to that issue. *Helvering* v. *Gowran*, 302 U. S. 238.

E.

The court below could not add to the findings of fact of the Board of Tax Appeals by assuming that because of the

relationship existing between the donor and the beneficiaries, it is wholly improbable that a beneficiary would resort to a court of equity to restrain an abuse of discretion by the trustee (R. 65), or that in view of the family relation a consent to termination of the trust would be freely given.

Under the stipulation of facts (R. 35), which facts were found by the Board as stipulated, the beneficiaries included two sisters and a sister-in-law, the only other beneficiaries being minors not *sui juris*. The assumptions by the court below that, because of the relationship existing between the donor and the beneficiaries, it is wholly improbable that a beneficiary would exercise his right to resort to a court of equity to restrain the discretion of the donor (R. 65) and (b) that "in view of the broad powers of the donor, as trustee, and the family relation, we think it may be reasonably assumed that such a consent (to terminate the trust) would be freely given", (R. 66), are assumptions of facts not found by the Board, and not appearing in the record. The court is without power to find facts or to add to or alter the findings of fact by the Board, *Helvering* v. *Rankin*, 295 U. S. 123, 130.

The Writs Should be Granted.

There are many cases in litigation before the Board of Tax Appeals and the courts at the present time involving trust instruments with similar provisions to those of the instant cases. The decision in all of such cases calls for the application of the rule announced in *Helvering* v. *Clifford*, 60 S. Ct. 554, 308 U. S.—, which rule, the petitioners believe, has been extended beyond its intendment by the decisions of the court below in the instant cases. It is, of course, difficult to find identical provisions in trust instruments or to find other cases involving exactly the same combination of trust provisions. However, the various decisions of the Board of Tax Appeals and the courts do

not give a harmonious interpretation of the rules announced in the case of *Helvering* v. *Clifford,* 60 S. Ct. 554, 308 U. S. —. For example, in the cases of *Dunlevy Milbank,* 41 B. T. A. #137, and *Lolita S. Armour,* 41 B. T. A. #105, the Board of Tax Appeals held that the doctrine of *Helvering* v. *Clifford* was not to be extended to cases in which the beneficiaries were merely relatives of the grantor and were not members of his immediate family circle. The following cases now in litigation all involve the question of whether or not powers reserved by the grantor or granted to trustees under the trust instruments were sufficient to make the trusts revocable trusts under section 166 of the Revenue Acts, or were sufficient to destroy the reality of the trusts and maks the income taxable to the grantor under section 22 (a) of the Revenue Acts. *Alfred C. Berolzheimer,* 40 B. T. A. 644, appealed by Commissioner to C. C. A. (Second Circuit); *Raol H. Fleischmann,* 40 B. T. A. 671; appealed to C. C. A. (Second Circuit); *Carleton H. Palmer,* 40 B. T. A. 1001, appealed by Commissioner to C. C. A. (Second Circuit); *Ellsworth H. Buck,* 41 B. T. A. 99, appealed by Commissioner to C. C. A. (Second Circuit); *Lolita S. Armour,* 41 B. T. A. #105; *Morton Stein,* 41 B. T. A. #134; *Edna B. Elias,* 41 B. T. A. #148; *Henry A. B. Dunning,* 41 B. T. A. #147, which involved the same trust instrument considered by the Board in *Henry A. B. Dunning,* 36 B. T. A. 1222; and *Frederic H. Frazier,* 41 B. T. A. 146, appealed by Commissioner to Circuit Court of Appeals (Second Circuit).

All of which is respectfully submitted for consideration of the Court.

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